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IN THE

Supreme Court of the United States

October Term, 1976

No. 76-272

FEDERAL DEPOSIT INSURANCE CORPORATION, as successor in interest to Franklin National Bank,

Petitioner,

v.

ISRAEL-BRITISH BANK (LONDON) LIMITED, Bankrupt,

Respondent,

and

BANK OF THE COMMONWEALTH,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner Federal Deposit Insurance Corporation prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit reversing the order of the District Court which dismissed Respondent's petition in bankruptcy for lack of subject matter jurisdiction.

Opinions Below

The opinion of the Court of Appeals is reported at — F.2d —(2d Cir. 1976) and is set forth in Appendix A in the

Joint Appendix.* The opinion of the District Court reversing the decision of the Bankruptcy Court which denied Petitioner's motion to dismiss Respondent's bankruptcy petition is reported at 401 F. Supp. 1159 (S.D.N.Y. 1975) and is set forth in Appendix B. The opinion of the Bankruptcy Court is reported (unofficially) at 1 Bankr. Ct. Dec. 528 and is set forth in Appendix C.

Jurisdiction

The judgment of the Court of Appeals was entered on May 25, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1966).

Question Presented

Does the District Court have jurisdiction to entertain a voluntary petition in bankruptcy of a banking corporation organized under the laws of a foreign nation, in the face of Section 4(a) of the Bankruptcy Act which excludes a "banking corporation" from the persons entitled to become bankrupts?

Statutes Involved

Sections 1(8), 1(23), 2(a)(1) and 4 of the Bankruptcy Act, 11 U.S.C. §§ 1(8), 1(23), 11(a)(1) and 22 (1970), are set forth in Appendix D.

Statement of the Case

Petitioner Federal Deposit Insurance Corporation ("FDIC") seeks review of the decision of the Court of

* Reference is to the Joint Appendix filed herewith on behalf of Petitioner and co-Petitioner Bank of the Commonwealth which was also an appellee in the Court of Appeals. Subsequent references to Appendices are also to the Joint Appendix, e.g. "JA-2-a."

Appeals, which reversed the order of the District Court dismissing the voluntary petition in bankruptcy of Respondent Israel-British Bank (London) Limited ("IBB").

IBB was organized under the laws of the United Kingdom as a corporation and was there authorized to and did function solely as a bank engaged in traditional banking activities in the United Kingdom and the international banking community. These activities included borrowing Eurodollars and U.S. dollars from American banks and maintaining deposits in American banks. [JA-2-a].

On July 26, 1974 Franklin National Bank ("Franklin"), predecessor in interest to FDIC, filed a complaint in the District Court styled *Franklin National Bank* v. *Israel-British Bank (London) Ltd.*, 74 Civ. 3232 (S.D.N.Y. 1974), seeking damages for nonpayment of a $2 million Eurodollar loan it had made to IBB. That same day Franklin obtained an order of attachment on the basis of IBB's status as a non-resident defendant and thereafter levied upon the assets (deposits) of IBB in a number of banking institutions in New York City.

On August 2, 1974, IBB filed a petition with the High Court, Chancery Division of the United Kingdom seeking a voluntary winding-up of its affairs and thereafter the court approved this petition.

On September 23, 1974, IBB, acting through its provisional liquidator appointed by the High Court, filed a voluntary petition in bankruptcy in the District Court pursuant to Section 2(a)(1) of the Bankruptcy Act ("Act"). Thereafter, Franklin moved to dismiss IBB's petition. The basis of this motion was that under Section 4(a) of the Act the court was without jurisdiction over the subject matter of the proceeding. Section 4(a) provides: "Any person, except a . . . banking corporation . . . shall be entitled to the benefits of this Act as a voluntary bankrupt."

The Bankruptcy Court denied Franklin's motion to dismiss. FDIC, which had succeeded to the assets of Franklin,[1] appealed to the District Court which reversed and dismissed IBB's petition. On May 25, 1976 the Court of Appeals reversed the District Court and found that, while IBB was a banking corporation, it was not authorized to and did not conduct a banking business in the United States. On this basis the Court held that IBB was not a "banking corporation" within the meaning of Section 4(a) of the Act.

Reasons for Granting the Writ

The Court of Appeals Has Decided an Important Federal Jurisdictional Question Which Has Not Been, but Should Be, Settled by this Court.

The federal question presented by this petition concerns the extent to which Congress has exercised its power to establish uniform laws on the subject of bankruptcies, pursuant to Article 1, Section 8 of the Constitution. Its resolution will have a substantial impact on the administration of the Bankruptcy Act relative to a sector of economic activity of the highest national and international importance.

Judge Lasker's opinion in the District Court recognized that the issue in this case is "of great significance to the international banking community." [JA-1-b]. The opinion of the Court of Appeals recognized that the question was of high importance and concerned the division of power between the federal government and the states. [JA-8-a].

In addition to the instant proceeding and the other civil actions relating to it,[2] there are two other bankruptcy pro-

1. *See In the Matter of the Liquidation of Franklin National Bank*, 381 F. Supp. 1390 (E.D.N.Y. 1974).

2. These are: FDIC's civil action based upon its Eurodollar loan to IBB; a proceeding by FDIC against one of its garnishees; and an action brought by Bank of the Commonwealth, also an appellant below, against IBB based upon an unpaid loan.

ceedings involving foreign banking corporations in the Southern District of New York, which involve the same issue. *In the Matter of Banque De Financement S.A.*, No. 75 B 764 (S.D.N.Y. 1975) (a Chapter XI proceeding); *In Re Israel-British Bank, B.M. Tel Aviv*, No. 74 B 1635 (S.D.N.Y. 1974) (an involuntary bankruptcy proceeding involving the Israeli parent of Respondent brought under Section 4(b) of the Act).[3]

Available statistics do not permit a projection of the dollar amount of assets which could be made subject to United States bankruptcy proceedings on the basis of the decision below for there is no compilation of assets held in the United States by foreign banking corporations not here conducting a banking business. By any reckoning the figure is great considering the growth of activity in foreign exchange transactions, the growth of domestic credit extended by foreign banking corporations and the growth of direct investment by foreign banking corporations in United States corporations, including domestic banking corporations.[4] The likely consequence of another financial crisis similar to that experienced in the latter part of 1974 is that other bankruptcy proceedings involving foreign banking corporations will be filed if the decision below is left undisturbed. Such actions could present real dangers to the stability of our domestic banking system and the international banking community.

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3. Whether the proceeding under the Act be filed pursuant to Section 4(a), Section 4(b) or Chapter XI, the issue is the same since the relevant wording of the exception in Sections 4(a) and 4(b) is *exactly* the same and Section 306(3) of the Act, 11 U.S.C. § 706(3) (1970), defines "debtor" to include a person who could become a bankrupt under Section 4 of the Act.

4. For example, as of June 1975, 175 United States banking institutions owned by foreign parent banks (which foreign parent banks may not necessarily be doing a banking business in the United States) reported that they held assets totaling $57.3 billion. U.S. Department of Commerce, *Interim Report to Congress: Foreign Direct Investment in the United States, Appendix VIII, Foreign Banking in the United States*, at VIII-7 (1975).

The success of our domestic banking institutions depends upon the confidence which depositors repose therein. Congress created the FDIC to foster this confidence by "bringing to depositors sound, effective, and uninterrupted operation of the banking system with resulting safety and liquidity of bank deposits." H.R. Rep. No. 2564, 81st Cong., 2d Sess. 3 (1950). The special character of banks and the delicate problems involved in preserving credit require that the FDIC seek to assure that domestic banks will not close their doors to depositors. *E.g., In the Matter of the Liquidation of Franklin National Bank,* 381 F. Supp. 1390 (E.D.N.Y. 1974).

The task of assuring the sound operation of domestic banking institutions cannot, however, be achieved without regard to the operation of the international banking community and foreign banking institutions. A bank, whether domestic or foreign, depends for its existence largely upon its deposit-taking function. A bank is thus peculiarly vulnerable to serious deposit outflow if conditions cast the slightest suspicion upon the soundness of its financial condition. The mere commencement of a bankruptcy proceeding in the United States against or by a foreign bank would undoubtedly have a devastating effect upon the particular institution and could impair the confidence of the public in the international banking community and our domestic banking system. National Bankruptcy Conference, *Report of Special Committee on Insurance Companies and Foreign Banks,* Part I: Foreign Banks at 16, fn. 1-2 (1975); Note, *United States Bankruptcy Jurisdiction over Unregulated Foreign Banks,* 17 Harv. Int'l L.J. 359, 376-377, fn. 59-61 (Spring, 1976). This has been the case historically, for in 1837 and again in 1931 foreign bank failures contributed to financial crises in the United States; indeed the latter was a contributing cause to worldwide depression. M. Friedman & A. Schwartz, *A Monetary History of the United States 1867-1960,* 314 (1963); S. Morison, *Oxford History of the*

American People, 455 (1965). Presently, the problem is more acute because of the growing intimacy between foreign and domestic banking institutions.

The FDIC's concern with the decision below is not limited to its effect only in the case of a voluntary petition. Since the relevant language of Section 4(a) of the Act is identical to the banking corporation exclusion in Section 4(b), the precedent established by the decision below makes foreign banks susceptible to involuntary bankruptcy petitions. In times of financial stress we can expect that unsatisfied domestic creditors of foreign banks will seek to file involuntary bankruptcy petitions against such foreign banks. This has already occurred, in the case of Israel-British Bank Limited, Respondent's parent, p. 5 *supra,* and *Bankhaus I.D. Herstatt KGa A.I.L.,* No. 74 B 1134 (S.D.N.Y. 1974). Such action (and the predictable public reaction) could affect the stability of and confidence in domestic banks and could severely frustrate the efforts of a foreign government which may, at the same time, be attempting to solve the financial problems of such a bank, as the FDIC would in the case of a domestic bank.

Finally, the effect of the decision below is likely to have a severe impact upon the treatment by host countries of United States banks engaged in foreign activities and the role of domestic banks in the development of multinational banking. There is a close relationship between the treatment of foreign banks in the United States and the treatment of domestic banks in foreign countries; the notion of reciprocity is fundamental in the international banking community. The principal of reciprocity encouraged by the United States is one of "mutual non-discrimination"—foreign banks should be treated on the same basis as domestic banks without discrimination in favor of either group. U.S. Department of Commerce *Interim Report, supra* note 3, at VIII-30, VIII-39; National Bankruptcy Conference, *Report, supra* p. 6 at 17-18.

In view of this principle and the precedent established below, it is unlikely that a domestic bank with assets abroad could successfully assert the position that a foreign nation should not permit it to be the subject of a foreign bankruptcy or insolvency proceeding at the behest of foreign creditors. The repercussions of such foreign proceedings could disrupt our domestic banking system, producing effects directly contrary to the reasons expressed by Congress for excepting banking corporations from the provisions of the Act, including the quasi-public nature of banks, the existence of interests other than those of creditors, and the inappropriateness of applying bankruptcy machinery to banking affairs. [JA-26-b]. These important policy considerations, which are no less applicable to foreign banks than domestic banks, were not considered by the Court of Appeals. *See* p. 9, *infra.*

Because the impact of the decision below will have a pervasive effect upon the banking industry and will affect our relations with foreign nations, the FDIC urges that this Court review the question presented.

The Court of Appeals Decision is Incorrect, Represents an Unauthorized Exercise of Congress' Legislative Function, and Conflicts in Principle With Two Other Decisions of this Court.

Acting under the guise of statutory construction, the Court of Appeals altered a fundamental statutory program enacted by Congress pursuant to an express Constitutional grant. Proper regard for the role of the judiciary should have compelled the court to apply the plain words of Section 4 as enacted and to leave to Congress the role of examining the policy considerations relevant to the question presented, only *some* of which were weighed by the court in reaching its decision. Rather, the Court of Appeals disregarded the plain words of Section 4 of the Act and

engrafted a new limitation upon the words "banking corporation." It apparently justified the resulting expansion of federal bankruptcy jurisdiction on the ground that the reported Congressional debates did not *expressly* refer to foreign banking corporations, and by pursuing severely limited policy considerations—a professed desire to "avoid an inequitable result to [IBB's] creditors" [JA-12-a] and to assume a role in aid of IBB's United Kingdom winding-up proceeding, [JA-3-a, 4-a]. In so doing, the Court of Appeals erred.

(1) Section 4(a) of the Bankruptcy Act excludes a "banking corporation" from the "persons" entitled to become bankrupts. Nothing in this language or any other part of the Act indicates that it does not mean what it says, *i.e.*, that it covers all banking corporations, foreign as well as domestic.* That the term "banking corporation" cannot be limited by excluding foreign corporations is made manifest by Section 4(b) of the Act which uses the term "corporation" twice, *e.g.*, a "commercial corporation" is included in and a "banking corporation" is excluded from the Act. Since the first usage includes a foreign corporation, Congress could not have intended to limit the second usage to domestic banking corporations without express limiting language. This result is further compelled by the fact that the Act's immediate predecessor did contain words of limitation which expressly excluded "banks incorporated under State or Territorial laws." Pub. L. 171, 55th Cong., 30 Stat. 544, chap. 541. If Congress intended the words "banking corporation" to be limited to domestic banks and to exclude foreign banks, it would have retained those words of limitation.

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* Indeed, under Sections 1(23), 1(8) and 2(a)(1) of the Act, read together, "persons" (including "corporations") "who do not have their principal place of business, reside or have their domicile within the United States" may be adjudged bankrupts provided they "have property within [the] . . . jurisdiction" of a court of bankruptcy and, it would seem clear, are not excepted by the provisions of Section 4.

(2) The Court of Appeals justified its result by indicating that the Act's exceptions should be "narrowed and limited" to effect its remedial theme of equality of distribution among creditors. [JA-7-a]. Thus guided, the court's premise ran afoul of principles heretofore established by this Court and as a consequence it substantially shifted the allocation of power over local property between the states and the federal government.

This Court has indicated that for those corporations excluded from the Act by Section 4, equality of distribution is not the rule and was never intended by Congress to be the rule. Rather, this Court has established the principle that if Congress has not exercised its bankruptcy power under Article I, Section 8 of the Constitution, *i.e.*, by excluding certain types of corporations from the Act, it is for the states to decide whether to recognize the theme of equality of distribution, adopt some alternative theme or submit excluded corporations to dismemberment, however great the inequality, in the interests of protecting local creditors. *Clark* v. *Williard,* 294 U.S. 211, 214-15 (1935) and 292 U.S. 112, 123 (1934). Thus, it was an error for the Court of Appeals to consider the goal of equality of distribution in determining the extent of Congress' jurisdictional grant. The lower court wrongly based its analysis on the guiding principle that the generic phrase "banking corporation" should be limited in the interests of furthering a remedial theme which Congress did not intend to be pursued for excepted corporations.

This Court should decide whether *Congress* intended to extend federal bankruptcy jurisdiction over foreign banking corporations and thus infringe upon the power of the states to protect local creditors who deal with foreign banks by permitting such creditors to levy upon local assets to satisfy their claims.

(3) Heretofore this Court has recognized that the Act of 1910, from which Section 4 of the Act in its present form

is derived (Act of June 25, 1910, ch. 412, §§ 3-4, 36 Stat. 839), substantially changed the prior law, which conditioned federal jurisdiction in bankruptcy upon factual inquiries into the actual business engaged in by prospective bankrupts. On the other hand, the prohibition of jurisdiction over excluded corporations under the present Act is "peremptory." *Vallely* v. *Northern Fire Ins. Co.*, 254 U.S. 348, 355-56 (1920). *See, e.g., Sims* v. *Fidelity Assurance Ass'n*, 129 F.2d 442, 448 (4th Cir. 1942), *aff'd*, 318 U.S. 608 (1943).

The decision below opens the door to factual inquiries which Congress itself closed, and will lead to disruption of the statutory scheme, as this Court cautioned in *Vallely, supra*, at 356. Issues of what type of and how much domestic activity constitute "doing business" for purposes of Section 4 will lead bankruptcy courts, attempting to determine bankruptcy jurisdiction, into factual inquiries proscribed since 1910.

Moreover, as the Court recognized in *Vallely*, embarking on an inquiry of this nature with respect to one type of excluded corporation will set off similar inquiries for all the others. As a logical consequence, railroad and insurance corporations, for example, organized under the laws of foreign nations and having assets in the United States, also will be subject to jurisdiction under the Act, if on a factual inquiry it is determined that these corporations are not engaged in or authorized to conduct the enumerated businesses in the United States.

This Court should review the decision of the Court of Appeals in light of this Court's earlier decisions construing the peremptory nature of the Act's exceptions.

(4) In fashioning its result for the purpose of assuming a role in aid of IBB's United Kingdom winding-up proceeding, the Court of Appeals in effect created jurisdiction to afford comity where Congress left to the states the option of whether they would afford comity by subordinating the lien of an attaching creditor to title asserted by a foreign

bankruptcy trustee or receiver. *Compare Martyne* v. *American Union Fire Ins. Co.*, 216 N.Y. 183, 110 N.E. 502 (1915), where considerations of comity dictated that a New York creditor could not attach property because title had vested in the insurance commissioner of another state by statute, with *Paine* v. *Lester*, 44 Conn. 196 (1876), where, considerations of comity notwithstanding, an attachment by a Rhode Island resident was permitted of a debt due from a Connecticut resident to an insolvent Pennsylvania corporation which had previously assigned its property to a trustee for creditors.

In so doing the Court of Appeals decided that an attachment presents more dangers to a foreign bank than a bankruptcy proceeding. But it is for Congress to decide whether "the notoriety of a bankruptcy proceeding and its connotation are likely to have a much more severe impact than an attachment." National Bankruptcy Conference, *Report, supra* p. 6 at 17.

This Court should review the decision of the Court of Appeals to determine whether it stepped beyond the bounds of judicial restraint and whether the District Court properly perceived the judiciary's role in interpreting Section 4 by recognizing that:

> "There is no provision in the Act which states that a foreign corporation must *operate* as a bank within the United States in order either to enjoy the benefits of bankruptcy or to fit within the Act's exceptions, and of course the courts cannot write such a requirement into the Act." [JA-4-b].

Conclusion

This Court should grant the petition for a writ of certiorari to review the issues raised herein on the merits.

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